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IMPACT OF CROSS-BORDER MERGERS AND ACQUISITIONS ON DEVELOPMENT AND POLICY ISSUES FOR CONSIDERATION

Note by the UNCTAD secretariat

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INTRODUCTION

1. The Executive Session of the Trade and Development Board decided on 12 May 2000 to convene, for 19–21 June 2000, an expert meeting in Geneva on " Mergers and acquisitions: Policies aimed at maximizing the positive and minimizing the possible negative impact of international investment". The meeting is part of UNCTAD's efforts to help improve the understanding of key issues in the area of foreign direct investment (FDI), and the latter's impact on development and policy options, particularly as they relate to developing countries and economies in transition, and to strengthen national capabilities to formulate and implement policies, measures and action programmes.

2. Virtually all countries seek to attract FDI, especially when it takes the form of greenfield investment (i.e. the establishment of new foreign affiliates), as such investment can make a contribution to economic development. Partly as a result of the efforts to attract FDI, cross-border mergers and acquisitions (M&As) are becoming more common than before as a mode of entry for transnational corporations (TNCs) in developing countries, as well as economies in transition. However, the question arises whether M&As, as opposed to greenfield FDI, can play the same role in contributing to the development process (this is not to suggest, however, that the nature of the contribution of greenfield investment to development cannot also be variable). They are viewed differently from greenfield FDI, since at the time of entry they do not add to national productive capacity but merely represent a change of ownership from domestic to foreign hands. Moreover, M&As are sometimes seen as depriving host countries of valuable national assets produced by domestic savings, labour and entrepreneurial effort, and as having the potential for creating a number of problems, such as market concentration and abuse of market power. Indeed, cross-border M&As, particularly those involving large TNCs from developed countries, vast sums of finance and reorganizations of economic activities, are among the most visible faces of globalization. And, as in the case of globalization in general, the impact of M&As on development can be double-edged and uneven. Concerns arise, therefore, as to the balance of the benefits and costs for FDI host economies in the form of cross-border M&As (as compared with greenfield FDI).

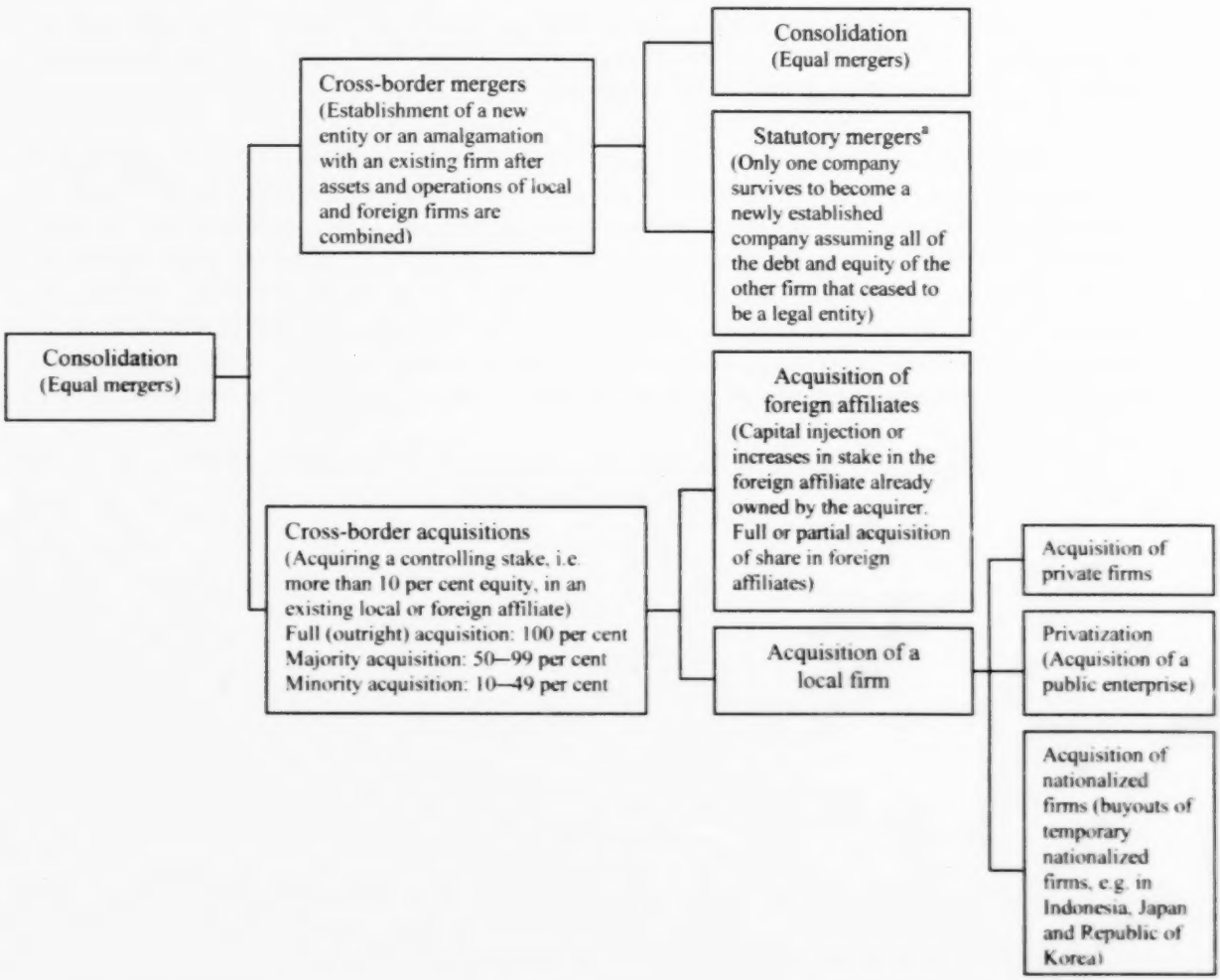
3. This note describes, briefly, trends in M&As and discusses some of the characteristics of the phenomenon. It then attempts to capture the concerns of Governments and other stakeholders, with a view to identifying where differences exist as regards the impact of M&As versus greenfield FDI and how, in these cases, potential benefits for economic development arising from M&As can be maximized and negative effects minimized.

I. TRENDS AND CHARACTERISTICS OF CROSS-BORDER M&As

4. FDI can take the form of either greenfield investment or a merger or acquisition (figure 1). Greenfield FDI is new investment made by setting up a new foreign affiliate. Investment through cross-border M&As is made either through foreign firms merging with domestic firms (the results of which are new entities) or foreign firms taking over existing domestic firms (which become new foreign affiliates). Cross-border M&As can involve private firms only, or can take the specific forms of privatization with the participation of foreign buyers (box 1). Since acquisitions are considerably more important in developing countries and economies in transition than mergers, the following discussion applies essentially to acquisitions.

5. The value of worldwide M&As — be they concluded between domestic firms or between domestic and foreign firms — has grown dramatically during the past two decades (1980–1999), at the rate of 42 per cent a year. In 1999, their completed value was about $2.3 trillion, representing 24,000 deals. During this period, there were two M&A waves: during the late 1980s (1988–1990) and from the mid-1990s (1995 onwards). In comparison with the late 1980s, most M&As in the current period are considered as a means of achieving strategic and operational, rather than financial, corporate objectives.

Figure 1. The structure of cross-border M&As


Consolidation
(Equal mergers)
Cross-border mergers
(Establishment of a new entity or an amalgamation with an existing firm after assets and operations of local and foreign firms are combined)
Consolidation
(Equal mergers)
Statutory mergers[a]
(Only one company survives to become a newly established company assuming all of the debt and equity of the other firm that ceased to be a legal entity)
Cross-border acquisitions
(Acquiring a controlling stake, i.e. more than 10 per cent equity, in an existing local or foreign affiliate)
Full (outright) acquisition: 100 per cent
Majority acquisition: 50—99 per cent
Minority acquisition: 10—49 per cent
Acquisition of foreign affiliates
(Capital injection or increases in stake in the foreign affiliate already owned by the acquirer. Full or partial acquisition of share in foreign affiliates)
Acquisition of a local firm
Acquisition of private firms
Privatization (Acquisition of a public enterprise)
Acquisition of nationalized firms (buyouts of temporary nationalized firms, e.g. in Indonesia, Japan and Republic of Korea)

Source: UNCTAD.

[a] The key difference between statutory mergers and full acquisitions lies in the fact that a new legal entity is established in the former, but not in the latter. These two forms, however, may otherwise be treated as identical.

8. Developed countries are the most important sellers and buyers in cross-border M&A deals, accounting for close to 90 per cent and 95 per cent of sales and purchases, respectively, in 1998–1999. Of the 5–10 per cent of sales/purchases involving developing countries, the bulk (70 per cent) originates in Latin America and the Caribbean. Cross-border M&A sales by developing countries increased from $12 billion in 1991–1995 to $61 billion in 1996–1999. The value of M&A purchases by firms from developing countries rose from an average of $8 billion in 1991–1995 to $30 billion in 1996–1999.

9. Western European firms expanded their cross-border M&A activity the most in 1999, in terms of both sales and purchases (table 1). The United States was the country with the largest value of sales. The United Kingdom became the largest acquirer in 1999, replacing the United States. This partly explains the position of these two countries as the largest outward investor (United Kingdom) and the largest FDI recipient (United States). If all cross-border M&As in developed countries were financed by FDI (see, however, the qualifications in paragraph 7), they would account for 95 per cent of FDI inflows during 1996–1999, compared to 67 per cent in 1991–1995.

Table 1. Cross-border M&As:[a] sales and purchases, 1998-1999
(Billions of dollars)

Region/economy	Sales		Purchases	
	1998	1999	1998	1999
Developed countries	**445.1**	**644.6**	**511.4**	**677.3**
of which:				
European Union	187.9	344.5	284.4	497.7
United States	209.5	233.0	137.4	112.4
Japan	4.0	15.9	1.3	9.8
Developing countries	**80.7**	**63.4**	**19.2**	**41.2**
of which:				
Africa	0.7	0.6	0.2	0.4
Latin America and the Caribbean	63.9	37.2	12.6	24.9
Europe	-	0.3	-	-
Asia	16.1	25.3	6.4	15.9
West Asia	0.1	0.2	0.4	5.3
Central Asia	0.2	0.1	-	-
South, East and South-East Asia	15.8	25.0	6.0	10.6
Pacific	-	0.1	-	-
Central and Eastern Europe[b]	**5.1**	**10.3**	**1.0**	**1.6**
Unspecified	0.7	1.8	-	-
World[c]	**531.6**	**720.1**	**531.6**	**720.1**

Source: UNCTAD, cross-border M&A database, based on data from Thomson Financial Securities Data Company.

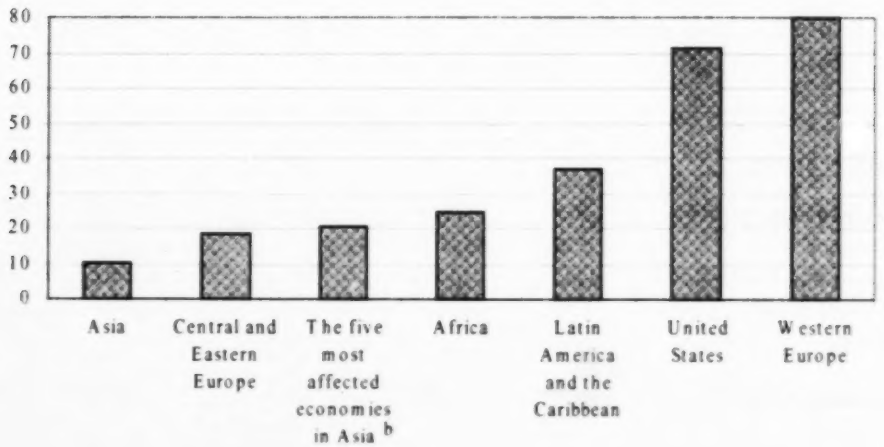
[a] Cross-border M&As that result in the acquisition of more than a 10 per cent equity share.

[b] Includes the countries of the former Yugoslavia.

[c] Includes amounts which cannot be allocated by region.

10. In developing countries, cross-border M&A sales fell in 1999 (table 1). This decline was largely caused by the smaller number of privatizations in Latin America, where the value of cross-border M&As fell from $64 billion in 1998 to $37 billion. By contrast, in developing Asia, cross-border M&As continued to grow. In particular, cross-border M&As in the five Asian countries most affected by the financial crisis were still on the increase, growing in value from $11 billion in 1998 to $15 billion in 1999. The value of cross-border M&A sales in Central and Eastern Europe doubled between 1998 and 1999 from $5 billion to $10 billion, primarily as a result of privatization programmes. If all cross-border M&As in developing countries were financed by FDI (see, however, the qualifications in paragraph 7), the ratios involved would vary considerably among developing regions, being highest in Latin America (figure 3). Overall, however, the ratio has risen from an average of 15 per cent in 1991–1995 to 35 per cent in 1996–1999.

Figure 3. Cross-border M&As[a] as a percentage of FDI inflows, 1996–1997
(Percentage)



Source: UNCTAD, based on *World Investment Report 1998: Trends and Determinants* (New York and Geneva: United Nations, United Nations publication, Sales No. E.98.II.D.5); and UNCTAD FDI/TNC database.

Note: See paragraph 7 for the qualifications.

[a] Majority foreign-owned M&As only.

[b] Indonesia, Malaysia, Philippines, Republic of Korea and Thailand.

11. Industries that have displayed high levels of cross-border M&A activity include automobiles, pharmaceuticals, chemicals, food, drink and tobacco in the manufacturing sector, and telecommunications, energy and financial services in the services sector. At a more detailed level of classification, M&A activity in the radio-telephone (mobile telephone), transport and storage, and communications industries was by far the highest in recent years, followed by life insurance and telephone communications (excluding radio-telephone and electronic services). All of these industries have long attracted large-scale cross-border M&As, partly because of liberalization and deregulation moves within them.

12. Why do firms increasingly engage in cross-border M&As? At the level of the firm, the main reasons for M&As, whether domestic or cross-border, include the search for new markets or increased market power, improved efficiency through synergy, size, risk diversification, financial motivations, as well as the personal motives of senior managers. Moreover, M&As are preferred when it is necessary to take swift action. Changes in the global environment have also contributed to an increase in M&As in recent years. Liberalization policies at the national, regional and global levels, not least in the area of FDI (box 2), coupled with technological innovations, have intensified global competition and have forced firms to respond. Cross-border M&As thus provide firms with a rapid way of restructuring to meet (or pre-empt) the moves of competitors, and to capture new business opportunities. The recent surge in cross-border M&As thus reflects the dynamic interaction between important changes in the global environment and motivating factors at the firm level.

Box 2. The regulatory framework

FDI that enters through cross-border M&As is subject to the general FDI regime, unless otherwise stated. In general, most FDI regimes do not seem expressly to make a distinction between investment through greenfield or by acquisition of a domestic firm. In other words, the same restrictive or liberal provisions apply to both forms of entry. In some cases, however, host Governments have imposed special authorization requirements for foreign M&As to ensure that the proposed arrangements do not have adverse consequences for the host economy; this is particularly the case where privatizations are involved.

In recent years, as FDI restrictions have gradually been liberalized and many FDI authorization requirements at the point of entry have been abandoned, countries seem to be increasingly turning to competition-based merger reviews to assess the effects of cross-border acquisitions of domestic companies on their economies. Often the new approach is based on a case-by-case review of large individual M&As, so that each transaction is judged on its own merits and within its particular context. These reviews rest predominantly on an economic analysis, of which competition (i.e. efficiency and consumer welfare) is a key standard, although other (public interest) criteria are also taken into consideration.

Sometimes Governments have used ad hoc interventions to influence the outcome of individual cross-border M&A deals or to encourage specific types of cross-border M&As — either by affecting the choice of foreign partners or by selecting deals in particular industries or locations — with a view to achieving some policy objectives and maximizing beneficial effects. In addition, Governments have used various policy tools to minimize negative effects — for example, certain capital controls, control of possible anti-competitive behaviour, taxation measures, and other measures concerning corporate governance and disclosure requirements.

Given the variety of policy approaches and instruments available, it is important to know more about what countries are doing and why, and to share experiences on how M&A policies have worked in practice.

Source: UNCTAD.

13. Whether M&As have improved enterprise performance remains a much-debated question. A survey of the existing literature, which is mainly based on United States data and domestic deals, suggests that a large number of M&As do not produce the expected results in terms of shareholder value. This is particularly true for the post-merger performance of the acquiring firms; there is, however, evidence of a more favourable impact on the target companies. Whether the observed rates of failure are high or low is difficult to determine, since it is not known how the individual firms would have managed in the absence of M&As. When assessing the outcome of M&As it is therefore necessary to take realistic counterfactuals into account. In a rapidly changing environment, firms often are forced to make strategic decisions in the light of competitors' moves and to estimate the cost of standing alone at a time when others merge.

14. The following questions are among the ones that could be examined by participating experts, on the basis of their country experiences:

(a) Can countries determine the main motivations of firms in cross-border M&As? Have motivating factors changed over time? Are some motivations more important in vertical M&As than in horizontal or conglomerate-type M&As? Do they differ by region? Do experts see the current M&A wave as likely to subside, or can one expect a continuing increase in cross-border M&As?

(b) What is the impact of M&As on the performance of the acquired and the acquiring firms (e.g. in terms of shareholder value, productivity, profitability and efficiency)?

(c) Do FDI regimes differentiate between greenfield FDI and cross-border M&As? If they do, what are these differences and what is the rationale for such differentiation?

(d) What are the principal reasons for host countries to allow cross-border M&As? Are cross-border M&As now generally allowed, encouraged or discouraged more than before? If so, what are the policy tools and criteria used and in what way have they changed?

(e) What are the experiences of host countries with policies and regulations dealing with cross-border M&As? What are the experiences of countries in negotiating specific commitments with foreign investors seeking to acquire assets, especially in the case of privatizations?

(f) Have countries introduced measures to avoid changes of ownership and control that are contrary to the public interest, or to prevent strategic decisions affecting the public interest? What measures have been used (e.g. golden shares) and how have these measures worked in practice? To what extent do countries screen foreign investors by type of entry?

(g) To what extent do countries, in their efforts to attract FDI, differentiate (when providing incentives) between greenfield FDI and cross-border M&As? To what extent have countries targeted foreign firms for specific M&As?

II. IMPACT ON HOST-COUNTRY DEVELOPMENT, AND POLICY ISSUES

15. Since foreign direct investors are using cross-border M&As more frequently as a mode of entry into host countries, the question arises as to what extent countries – and especially developing countries and economies in transition – should be concerned about this development. The scope for concerns is largely grounded in the difference between cross-border M&As and greenfield FDI at the time of entry, namely that M&As — by definition — represent simply a change of ownership rather than an addition to domestic productive capacity, perhaps resulting in an inadequate flow of assets and undesirable economic effects. Concerns can be further accentuated if, in the case of special circumstances, "fire sales" of domestic assets are seen to take place. If, furthermore, M&As take place in key industries, "denationalization" can become a political issue. Finally, M&As can give rise to concerns related to market-structure and competition.

16. This set of concerns is by no means exhaustive. Experts might wish to consider additional issues. They may also want to discuss how widespread these (and other) concerns are.

17. The text below is structured around the four sets of concerns mentioned above. In particular, it raises a number of questions as to the perceived impact of cross-border M&As on development. Many more questions could be raised. In each case, the issue is not to examine the impact of FDI per se but, rather, to examine the difference in the impact, if any, due to the mode of entry of foreign direct investors into host countries – M&As versus greenfield FDI. Where there are differences, the issue becomes one of identifying ways and means by which positive effects can be maximized while negative ones are minimized, also taking into account possible counterfactual situations. As the two modes of entry are not always feasible alternatives for TNCs and/or host countries (as, for example, in the case of some large-scale privatizations), the issue is then to examine the impact of M&As on the acquired enterprises and host economies. Experts may wish to focus particularly on policy implications for developing countries and economies in transition when deliberating on these issues.

A. Impact on economic development

18. One of the reasons why FDI is welcomed by countries is that it brings a package of tangible and intangible foreign assets – capital, technology, skills, access to markets, and so on – that supplements domestic efforts to accelerate economic development. A transfer of such assets is particularly helpful under conditions of rapid technological change, liberalization and globalization which intensify the need for continuous and speedy upgrading of production capabilities. One issue before experts is to what extent cross-border M&As differ from greenfield FDI as a mode of asset transfer for development and economic restructuring as regards key areas of development:

- Increasing financial resources and investment;
- Enhancing technological capabilities;
- Boosting competitiveness in trade;
- Generating employment and improving skills;
- Strengthening competition in markets (this issue is discussed in greater length in the next section).

And, more important, as FDI is a package of assets, the broader issue is the difference, if any, in the impact of cross-border M&As on economic restructuring for development. More specifically, do cross-border M&As contribute *less* than greenfield FDI or can even have a negative impact in any or all of these areas to economic development and, if so, why? Do the differences between the two modes, if any, continue to prevail after the entry of FDI, i.e. during the life of foreign affiliates? During both the entry and the post-entry phase, the question then arises as to what policies can reduce any negative effects.

19. In relation to these concerns, specific issues that can be examined include:

(a) Are concerns regarding the role of FDI in key areas of development more, or less, pronounced in the case of M&As than in the case of greenfield FDI and, if so, why? Are there other important issues of concern? Does it matter whether the foreign investor is headquartered in a developed or a developing country?

(b) Are there differences between cross-border M&As and greenfield FDI in terms of their impact on external financial resource flows to host countries?

(c) To what extent is FDI through cross-border M&As followed by further investment that then adds to production capacity? Does this apply in the case of acquisitions of private firms as well as of privatized state-owned enterprises? Do cross-border M&As crowd out/in domestic firms more than greenfield FDI? Do M&As and greenfield FDI differ in terms of linkages with domestic enterprises?

(d) What is the experience of countries regarding the technological impact of M&As as compared with greenfield FDI? To what extent does "asset-stripping" and the closing of R&D facilities take place as a result of M&As?

(e) Do cross-border M&As help in boosting host countries' export competitiveness to the same extent as greenfield FDI does? Does the impact of the two types of FDI on imports differ?

(f) What are the experiences of countries as regards the employment effects of cross-border M&As? How do they differ from those of M&As involving only domestic firms?

(g) What is the experience of countries with these and related issues? What policy responses have they adopted and what is their experience with them? In particular, what specific precautions can Governments take to minimize potential negative effects?

(h) What is the role of cross-border M&As in the economic restructuring of individual countries? Does it differ from that of greenfield FDI?

B. Market structure and competition

20. Both greenfield FDI and cross-border M&As can give rise to competition policy concerns in host countries, regardless of the level of development. And, indeed, such concerns are among the most important ones raised in the context of cross-border M&As, for which reason they are

singled out here. Cross-border M&As can be used to reduce or even eliminate competition, thus posing challenges for maintaining effective competition in host economies by increasing market concentration at the time of entry. In addition, like all firms, the affiliates resulting from cross-border M&As can engage in various forms of anti-competitive behaviour once established, when conditions permit. Some market structure and competition concerns are related to M&As taking place between TNCs in other countries. These can have a secondary effect, as when, for example, affiliates of these TNCs in host countries also merge or simply stop competing with each other. There is also the concern that, as a result of large-scale mergers among TNCs in general, these firms could end up controlling increasingly large market shares and global distribution channels, thus making it difficult for smaller-scale enterprises based in developing and transition economies to compete on equal terms.

21. On the other hand, foreign entry through M&As may be beneficial in economies with protected industrial structures dominated by local conglomerates holding monopolistic or oligopolistic positions. In economies with high levels of share cross-holdings, strong corporate links with the government or financial institutions and opaque business practices, cross-border M&As can not only shake up and improve market structures but also introduce better corporate governance and management practices.

22. Issues concerning competition and market structure, as related to cross-border M&As, are complex. Ones that might be discussed include:

(a) What are the experiences of countries regarding the effects of cross-border M&As (versus greenfield FDI) on increasing or reducing competition in host country markets?

(b) What are the experiences of countries regarding anti-competitive behaviour of foreign affiliates created by M&As, after their establishment?

(c) What policy measures have been taken to limit the adverse competition effects of cross-border M&As, and what is the experience with them? To what extent do these measures distinguish between cross-border and domestic M&As?

(d) To what extent are national competition authorities monitoring developments in the world economy outside their jurisdictions with respect to M&As that can affect the competition situation in their own economies?

(e) What is the experience with international cooperation as regards cross-border M&As? Is there a need for a broader response at the international level to facilitate the review of cross-border M&As and, if so, what elements could it contain?

C. "Fire sales"

23. Cross-border M&As that take place under exceptional circumstances such as economic/financial crises or privatization programmes may give rise to particular concerns. The main concern is that prices set for acquired firms could be well below "normal" prices (that is, prices that reflect the net present value of future earnings). Particularly during a financial crisis,

27. In view of these considerations, issues that could be examined include:

(a) Are concerns about "denationalization" (and the trade-offs implied) more, or less, pronounced in the case of M&As than in the case of greenfield FDI and, if so, why?

(b) Is the acquisition of domestic firms and assets by foreign owners a concern from the viewpoint of national enterprise sector development?

(c) What economic gains from cross-border M&As may justify the reduction of domestic ownership of assets?

(d) Do countries bar entry through cross-border M&As in specific industries? If so, in what industries, and why? What tools are being used?

(e) Are there infant industry arguments for protecting domestic enterprises against cross-border M&As? If so, how can these arguments be put into practice?

(f) What policy measures can Governments take to ensure that minority shareholders and other stakeholders of domestic companies are not negatively affected by a foreign acquisition of their firm?

(g) What is the experience of countries with these and related issues? What policy responses have been adopted and what is the experience with them? In particular, what specific precautions can Governments take to minimize potential negative effects?

CONCLUSION

28. The increasing trend towards cross-border M&As as a mode of entry for FDI has begun to affect developing countries and economies in transition. While the overriding motives of firms undertaking M&As have been widely discussed, the impact of FDI through cross-border M&As on the development process of host countries has received little attention. In making an assessment of this impact, care needs to be taken to isolate the *additional* effects of cross-border M&As from those associated with FDI generally. In sum, more needs to be learned about the effects of cross-border M&As as compared with greenfield FDI and the policy options open to countries in this area. Questions that are among those to be addressed in this respect include the following:

(a) What specific precautions can Governments take to minimize potential negative effects of FDI through cross-border M&As?

(b) Is there a need for a case-by-case approach to assess the effects of cross-border M&As on host-country economies? If so, under what conditions?

(c) How far can Governments rely on negotiations with foreign investors to obtain maximum economic benefits from them, and under what conditions?